

[4830-01-p]

DEPARTMENT OF THE TREASURY

Internal Revenue Service

26 CFR Part 1

[REG-119436-01]

RIN 1545-AY87

New Markets Tax Credit

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Advance notice of proposed rulemaking.

SUMMARY: This document invites comments from the public on issues that the IRS may address in regulations relating to the new markets tax credit under section 45D. A taxpayer that makes a qualified equity investment in a qualified community development entity that has received a new markets tax credit allocation may claim a 5-percent credit for each of the first 3 years and a 6-percent tax credit for each of the next 4 years. All materials submitted will be available for public inspection and copying.

DATES: Written and electronic comments must be submitted by July 2, 2001.

ADDRESSES: Send submissions to: CC:M&SP:RU (REG-119436-01), room 5226, Internal Revenue Service, POB 7604, Ben Franklin Station, Washington, DC 20044.

Submissions may be hand delivered Monday through Friday between the hours of 8 a.m. and 5 p.m. to: CC:M&SP:RU (REG-119436-01), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue NW., Washington, DC. Alternatively, taxpayers may send submissions electronically via the Internet by selecting the "Tax Regs" option on the IRS Home Page, or directly to the IRS Internet site at

[http://www.irs.ustreas.gov/tax\\_regs/regslist.html](http://www.irs.ustreas.gov/tax_regs/regslist.html).

FOR FURTHER INFORMATION CONTACT: Concerning submissions, the Regulations Unit, (202) 622-7180; concerning the proposals, Paul Handleman, (202) 622-3040 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

Section 121(a) of the Community Renewal Tax Relief Act of 2000 (Public Law 106-554) (Act), amended the Internal Revenue Code (Code) to add the new markets tax credit. Section 45D(a)(1) of the Code provides a new markets tax credit on a credit allowance date in an amount equal to the applicable percentage of the taxpayer's qualified equity investment in a qualified community development entity (CDE). The credit allowance date for any qualified equity investment is the date on which the investment is initially made and each of the 6 anniversary dates thereafter. The applicable percentage is 5 percent for the first 3 credit allowance dates and 6 percent for the remaining credit allowance dates.

In addition, section 121(f) of the Act provides that not later than 120 days after the date of the enactment of the Act (Dec. 21, 2000), Treasury will issue guidance specifying how entities will apply for an allocation under section 45D(f)(2); the competitive procedure through which the allocations are made; and the actions that Treasury will take to ensure that the allocations are properly made to appropriate entities. The Secretary of the Treasury has delegated authority for issuing this guidance to the Under Secretary (Domestic Finance), who in turn has delegated the authority to the Director of Treasury's Community Development Financial Institutions Fund (Fund). Simultaneously with the issuance of this advance notice of proposed

rulemaking, the Fund is issuing separate guidance on how an entity may apply to become certified as a CDE; how a CDE may apply to receive an allocation of new markets tax credits; the competitive procedure through which the allocations will be made; and the actions that Treasury will take to ensure that the allocations are properly made to appropriate entities.

In developing guidance to assist taxpayers in applying the rules of section 45D, the IRS has identified certain issues that may be considered for guidance or other administrative pronouncements. The IRS invites comments from the public on the following issues and any other issues for which taxpayers believe guidance is needed.

1. The new markets tax credit may be claimed only with respect to qualified equity investments in a CDE. Section 45D(b)(1)(B) requires CDEs to use substantially all of the cash from a qualified equity investment to make qualified low-income community investments.

(a) How should “substantially all” be defined for purposes of section 45D(b)(1)(B)? For example, what percentage should constitute “substantially all” of the cash from a qualified equity investment?

(b) What amounts should be treated as used to make qualified low-income community investments? For example, how should issuance costs (including underwriter’s compensation) and reserves be treated?

(c) How much time under section 45D(b)(1)(B) should a CDE have to invest the cash from a qualified equity investment in a qualified low-income community investment?

(d) How should repayments of equity or principal in respect of a qualified low-income community investment be treated for purposes of section 45D(b)(1)(B)? For example, are there circumstances when a CDE should not be required to reinvest any such amounts in another qualified low-income community investment during the 7-year credit period?

(e) How should the “substantially all” requirement under section 45D(b)(1)(B) be administered during the 7-year credit period?

2. Section 45D(b)(3) contains a safe harbor under which the “substantially all” requirement of section 45D(b)(1)(B) will be treated as met if at least 85 percent of the aggregate gross assets of the CDE are invested in qualified low-income community investments.

(a) How should “aggregate gross assets” be defined under section 45D(b)(3)? For example, are there any assets of a CDE that should not be taken into account for these purposes?

(b) How should the aggregate gross assets of a CDE be determined under section 45D(b)(3)?

(c) How should compliance with the 85 percent test of section 45D(b)(3) be determined? For example, should the CDE be required to satisfy the test throughout the entire 7-year credit period following the issuance of a qualified equity investment? Should any grace periods be provided? If so, what should those grace periods be?

3. As indicated previously, section 45D(b)(1)(B) requires CDEs to use substantially all of the cash with respect to a qualified equity investment to make qualified low-income community investments. Under section 45D(d)(1)(A), the term “qualified low-income community investment” includes any capital or equity investment in, or loan to, any qualified active low-income community business. Section 45D(d)(2)(A) provides that the term “qualified active low-income community business” means, with respect to any taxable year, any corporation (including a non-profit corporation) or partnership if for the year (i) at least 50 percent of the total gross income of the entity is derived from the active conduct of a qualified business (as defined in section 45D(d)(3)) within any low-income community, (ii) a substantial portion of the use of the tangible property of the entity is within any low-income community, (iii) a substantial portion of the services performed for the entity by its employees is performed in any low-income community, (iv) less than 5 percent of the average of the aggregate unadjusted bases of the property of the entity is attributable to collectibles (as defined in section 408(m)(2)) other than collectibles that are held primarily for sale to customers in the ordinary course of the business, and (v) less than 5 percent of the average of the aggregate unadjusted bases of the property of the entity is attributable to nonqualified financial property (as defined in section 1397C(e)).

(a) How should “substantial portion” be defined for purposes of section 45D(d)(2)(A)(ii) and (iii)?

(b) When should the determination be made regarding whether a trade or business constitutes a “qualified active low-income community business”? For

example, should the determination be made at the time of the investment in the business based on reasonable expectations? Under what circumstances, if any, should an investment in a business lose its status as a “qualified low-income community investment” under section 45D(d)(1)(A) by reason of a failure of the business to satisfy the requirements for a qualified active low-income community business under section 45D(d)(2)? Should the degree of control of the CDE over the business be relevant to this determination?

(c) Should special rules be provided under section 45D(d)(2)(A) for determining whether a newly-formed entity meets the requirements for a qualified active low-income community business?

4. Section 45D(d)(1)(C) provides that the term “qualified low-income community investment” includes financial counseling and other services to businesses located in, and residents of, low-income communities. What types of services should constitute “financial counseling and other services” for these purposes?

5. Section 45D(d)(1)(D) provides that the term “qualified low-income community investment” includes any equity investment in, or loan, to a CDE.

(a) What restrictions, if any, should apply to the use by a CDE of the proceeds of a qualified low-income community investment received from another CDE?

(b) Under what circumstances, if any, should an investment by one CDE in another CDE lose its status as a “qualified low-income community investment”

under section 45D(d)(1)(D)? Should the degree of control of the investing CDE over the other CDE be relevant to this determination?

6. Under section 45D(g)(3)(B), a recapture event (requiring an investor to recapture credits previously taken) may occur with respect to an equity investment in a CDE if the CDE ceases to use substantially all of the proceeds of the equity investment for qualified low-income community investments.

(a) What circumstances should constitute a change in use of the proceeds of a qualified equity investment that triggers a recapture event under section 45D(g)(3)(B)?

(b) What remedial action(s), if any, should a CDE be permitted to take to avoid recapture under section 45D(g)(3)(B)?

7. Section 45D(i)(1) provides that Treasury may prescribe regulations that limit the new markets tax credit for investments that are directly or indirectly subsidized by other Federal tax benefits (including the low-income housing tax credit under section 42 and the exclusion from gross income under section 103). Under what circumstances should investments be treated as directly or indirectly subsidized by other Federal tax benefits?

8. Section 45D(i)(2) and (4) provides that Treasury may prescribe regulations that prevent the abuse of the purposes of section 45D and that impose appropriate reporting requirements.

(a) What anti-abuse rules may be necessary for carrying out section 45D?

(b) What types of reporting requirements should be imposed for carrying out section 45D?

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